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Supreme Court of the United States

OCTOBER TERM, 1934.

No. 625

REALTY ASSOCIATES SECURITIES CORPORATION and REALTY ASSOCIATES, INC.,

Petitioners,

vs.

EUGENE F. O'CONNOR, JR., FRED L. GROSS, HOMER E. PALMER et al., ALMON G. RASQUIN, ELIZA B. CARMAN et al., BONDHOLDERS' COMMITTEE of which WILLIAM E. KENNEDY, JR., is Chairman, MANUFACTURERS TRUST COMPANY and BONDHOLDERS' COMMITTEE of which FREDERICK S. ROBINSON is Chairman.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI OF REALTY ASSOCIATES SECURITIES CORPORATION AND REALTY ASSOCIATES, INC.

I.

The Opinions of the Courts Below.

The opinion of the District Court (R. p. 102) is reported in 6 F. Supp. 549.

The prevailing opinion of the Circuit Court of Appeals is not yet reported but is printed in the record (R. p. 152).

The dissenting opinion of Judge A. N. HAND is not yet reported but is printed in the record (R. p. 161).

II.

Jurisdiction.

The decision of the Circuit Court of Appeals was rendered December 3, 1934, and the order for the mandate thereon was entered December 10, 1934. The issuance of the mandate of the Circuit Court of Appeals has been stayed by that Court pending the consideration and decision of this petition for writ of certiorari.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by Act of Congress of February 13, 1925 (U. S. Code, Title 28, Sec. 347).

III.

Statement of the Case.

This is a bankruptcy proceeding.

The petition in bankruptcy was filed July 10, 1933 (R. pp. 2, 5).

The bankrupt duly made an offer of composition (R. p. 8) to its creditors pursuant to Section 12 of the Bankruptcy Act, which offer of composition was accepted by a majority in number and amount of creditors (R. p. 88).

The total amount of claims proved against the bankrupt estate was $13,008,038.30 (R. p. 65), all of which claims, with the exception of $208,133.90, were based upon bonds outstanding under three indentures between Realty Associates Securities Corporation and Manufacturers Trust Company, as Trustee, dated, respectively, July 1, 1925, December 1, 1927, and October 1, 1928 (R. pp. 9-10).

The corporation's assets with the exception of $3,331,295.72 in liquid assets—cash and investment securities—consisted of equities in real estate, mortgages and instalment contracts for the sale of real estate (R. pp. 5-7)

which, if liquidated in the course of administration in bankruptcy, would net a very small amount of money.

The offer of composition provided (R. pp. 9, 10) that the amount to be paid to creditors should be 15% of the amount of their claims as filed and allowed or scheduled; and that the remaining 85% of the amount on which said 15% is computed should be evidenced by the existing outstanding bonds as reduced and modified, as provided in said offer of composition. No new bonds were executed to evidence the remaining 85%; the composition offer provided that the existing outstanding bonds should be stamped with a notation that they had been reduced by such 15% payment, and that they were modified so as to be in conformity with the offer of composition and a new indenture referred to therein, by which the maturity of two of the three series of bonds was extended, the interest rate was reduced from 6% to 5% payable as earned, and certain modifications in protective covenants were prescribed.

The Referee's report on the composition was made on March 12, 1934 (R. p. 45).

The composition was confirmed by order of the District Court entered April 6, 1934 (R. p. 85).

The Referee claimed before the District Court that he was entitled to $65,040.19 as his compensation under Section 40 of the Bankruptcy Act, the same being one-half of one per cent of $13,008,038.30, the total amount of claims filed and allowed or scheduled, such claim being upon the theory that the creditors were to be paid one hundred cents on the dollar upon the confirmation of the composition.

The bankrupt objected to the inclusion in the sum upon which commissions were to be computed of any portion of the remaining 85% of the claims (15% being paid in cash) which were evidenced by the existing bonds as reduced and modified, except that if such existing bonds which were retained by the creditors after the composition were to be included at all in the sum upon which the

Referee's compensation was computed, such bonds should be included only at their market value at the time of the confirmation.

The District Court found that such market value of said bonds after the payment of said 15% in cash was 22, or the equivalent of $220 for the 85% remaining due upon each $1,000 bond retained by the creditors (R. p. 107).

The District Court held that, although the 85% of the old debt persisted undischarged (R. p. 106), it would be unfair to exclude such 85% entirely from the computation of commissions, and added the market value of the bonds retained by creditors to the amount actually to be paid to creditors upon the confirmation of the composition (R. p. 110).

The Court further found that the amount to be paid to creditors upon the confirmation of the composition was $4,812,974.17 (R. p. 97), which amount is made up of the total amount of priority claims, plus the 15% in cash on general claims, plus 22% (the value of the retained bonds) of such general claims.

This decision of the District Court resulted in fixing the Referee's compensation of $24,064.87, which is one-half of one per cent of $4,812,974.17 (R. p. 97).

The Referee and also Mr. Fred L. Gross, one of the receivers, whose compensation had been fixed by the District Court at $28,877.84 (R. p. 97), appealed to the Circuit Court of Appeals from that portion of the order confirming the composition which fixed their fees (R. pp. 115, 123).

The Circuit Court of Appeals affirmed the decision with reference to Mr. Gross' compensation as receiver, but modified (Judge A. N. Hand dissenting with opinion) the District Court's decision by holding that the Referee was entitled to compensation at the rate of one-half of one per cent upon the face amount of the bonds retained by the creditors (thus making the one-half of one per cent computed upon $13,008,038.30, the entire amount of the

claims), and that the Court had no jurisdiction to reduce the Referee's compensation even in cases where it appeared to be excessive or unreasonable.

IV.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In holding that the effect of the confirmation of the composition was to destroy the obligation upon bonds which the creditors were permitted to retain pursuant to the offer of composition, and to substitute a new obligation.

(2) In holding that the amount remaining due upon the bonds which the creditors retained constituted any part of "the amount to be paid to creditors upon the confirmation of the composition," and in allowing any commissions to the Referee on the amount so remaining due.

V.

Summary of Argument.

I.

THE ACCEPTANCE AND CONFIRMATION OF THE COMPOSITION DID NOT RESULT IN A SUBSTITUTION OF THE MODIFIED BONDS BY NEW OBLIGATIONS.

II.

THE "AMOUNT TO BE PAID TO CREDITORS UPON THE CONFIRMATION OF THE COMPOSITION" WAS ONLY 15% OF THE AMOUNT OF THEIR CLAIMS AS PROVED AND ALLOWED, OR SCHEDULED.

ARGUMENT.

POINT I.

The acceptance and confirmation of the composition did not result in a substitution of the modified bonds by new obligations.

The only provision for payment to creditors is contained in paragraphs 3 and 5 of the offer (R. p. 9), where it is provided that: "The amount to be paid to all creditors • • • shall be fifteen per cent. (15%) of the amount of their claims as filed and allowed or if not filed and allowed then fifteen per cent. (15%) of the amount at which such claims appear in the schedules in bankruptcy filed herein." No other payment in addition to this 15% was to be made. The offer, however, secures to the creditors, among other things, the right to retain the bonds in their possession after certain modifications were made thereon. The only important modifications are the change in the due date, reduction in interest, and reduction to 85% of their face amount (R. pp. 10, 11).

These modifications were made on the bonds which the creditors had in their possession at all times prior to the confirmation of the composition. Physically the bonds are the same.

Surely the modification of the bonds does not constitute payment except, possibly, to the extent of the 15% reduction.

The composition gives the creditors no additional rights in the bonds but merely reserves to them the rights represented by the original bonds as curtailed by express modification. The bonds are not new obligations of the company. As was stated by the District Court in its opinion (6 F. Supp. at 551):

> "However one may view the transaction, 85% of the old debt persists. It is not discharged. It

> survives in a modified form. To assert that acceptance of the offer of composition wipes out the old debt, because in terms it has been but modified, is to deal with verbal niceties which in no respect appeals to the conscience of the court."

The claims of creditors are still upon the old indebtedness, which is not destroyed. The confirmation of the composition destroyed the remedy but not the indebtedness represented by the bonds. *Zavelo* v. *Reeves*, 226 U. S. 625.

The order confirming the composition clearly indicates that the debt of the outstanding bonds continues. It provides, in part (R. pp. 92, 93):

> "Ordered (2), that Realty Associates Securities Corporation be and it hereby is discharged of all its debts other than such debts as are based upon such proportion of the existing bonds of Realty Associates Securities Corporation as continue and remain in existence as reduced and modified pursuant to the terms of said offer of composition as so modified."

This provision clearly excepts the bonds from the discharge effected by the acceptance and confirmation of the offer of composition.

The modified offer of composition provides that the composition, including the modification of the outstanding bonds, "shall be without prejudice to the rights, if any, of holders of such bonds against New York Investors, Inc., arising out of, under or in connection with the guarantee of said bonds by New York Investors, Inc., and all causes of action, if any, accruing to said bondholders by reason of such guarantee are hereby reserved unto them" (R. p. 23).

The holding of the Circuit Court of Appeals that the modified bonds are "new obligations" would seem to destroy the guarantee of the New York Investors, Inc., a valuable right which the offer of composition sought to preserve. This result would seem to follow from an

application of the rule that the substitution of one obligation by a new obligation, which varies essentially the terms of the original obligation, releases a guarantor of the first obligation. *Prairie State Bank* v. *United States*, 164 U. S. 227.

The offer should be so construed as to give meaning and effect to all of its terms. A construction which gives a reasonable meaning to all of its provisions should be preferred to one which leaves a portion of it useless. *E. I. Dupont DeNemours & Co.* v. *Claiborne-Reno Co.* (C. C. A. 8), 64 F. (2d) 224, cert. den. 290 U. S. 646.

The interpretation made by the Circuit Court of Appeals departs from such construction apparently destroying the valuable property right represented by the New York Investors, Inc., guarantee.

POINT II.

The "amount to be paid to creditors upon the confirmation of the composition" was only 15% of the amount of their claims as proved and allowed, or scheduled.

Section 40(a) of the Bankruptcy Act (11 U. S. C., Sec. 68[a]) provides:

> "Referees shall receive as full compensation for their services * * * one-half of one per centum on the amount to be paid to creditors upon the confirmation of a composition."

The offer of composition provides that "the amount to be paid to all creditors * * * shall be fifteen per centum (15%) on the amount of their claims as filed and allowed" or scheduled (R. p. 9). If the outstanding bonds were part of the consideration they would have to be deposited.

Section 12 of the Bankruptcy Act (11 U. S. C., Sec. 30) provides:

> "An application for the confirmation of a composition may be filed in the court of bankruptcy after, but not before, it has been accepted * * *, and the consideration to be paid by the bankrupt to his creditors, and the money necessary to pay all debts which have priority and the cost of the proceedings, have been deposited in such place as shall be designated by and subject to the order of the judge."

Rule 13 of the Bankruptcy Rules of the District Court of the United States for the Eastern District of New York provides:

> "13. APPLICATION FOR CONFIRMATION OF COMPOSITION.
>
> Application for the confirmation of a composition shall be filed, in all cases, with the clerk of the court, and the consideration to be paid by the bankrupt to his creditors and the money necessary to pay all debts which have priority and the costs of the proceedings shall be deposited with the clerk, who shall certify the fact to the court, and thereupon a day for the hearing before the judge shall be fixed by the order of the court."

The composition has proceeded on the unquestioned basis that the deposit with the Court of the 15% was a deposit of the entire consideration to be paid by the bankrupt to its creditors. This is proved by the District Court's finding that the consideration to be paid by the bankrupt had been duly deposited (R. p. 85).

The outstanding bonds not having been deposited or filed, they cannot constitute any part of the consideration to be paid by the bankrupt to its creditors upon the confirmation of the composition.

Debts unaffected by a composition are excluded in computing commissions. *In re Chimovitz* (D. C.), 30 F. (2d) 114.

Since the various modifications referred to in Point I hereof do not affect the substance of the obligation in

such a way as to constitute new bonds but are mere incidental covenants and not new covenants for the payment of money, the amount due is still represented by the original bonds and is not part of the amount paid to creditors upon the confirmation of the composition.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, that a writ of certiorari should be granted to the Realty Associates Securities Corporation and the Realty Associates, Inc., and that this Court should review the decision of the Circuit Court of Appeals and finally reverse it.

Dated, New York, January 21, 1935.

ARCHIBALD PALMER,
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